

Committee on Resources

Subcommittee on Water & Power

Witness Statement

**Testimony of
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**Before the
U.S. House of Representatives Resources Committee
Subcommittee on Water and Power**

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My name is Jack Speer. I am the Northwest Energy Leader for Alcoa Inc. Alcoa has purchased power directly from the Bonneville Power Administration ("BPA") for close to 60 years. The company has three facilities in the Pacific Northwest with approximately 2000 employees.

Six other aluminum companies are located in the Pacific Northwest and purchase power directly from Bonneville. All together, the Northwest aluminum industry employs close to 9,000 people directly and 30,000 people indirectly. Aluminum's direct annual economic contribution to the region is estimated at over \$3 billion. The Northwest produces 40 percent of the nation's aluminum, making it the top aluminum-producing region in the country.

The relationship between Bonneville and the Northwest aluminum companies is changing. Some of the aluminum smelters are Bonneville's oldest customers. Alcoa announced plans to build its first Northwest facility in 1939. Indeed, Alcoa and the other companies were encouraged to locate in the Northwest by the federal government in part to provide Bonneville a revenue stream at a time when there were no other power customers. It was a mutually beneficial relationship. Bonneville was able to sell a large amount of power and reap the corresponding financial benefit, and the companies had access to a ready supply of low-cost power. The aluminum manufactured in the region was then used to supply the aerospace manufacturing needs of the WWII effort, and the entire process - water to power to aluminum to airplanes - helped develop the fledgling Northwest economy.

When Congress passed the Northwest Power Act in 1980, the aluminum industry still played a major role in BPA's customer base. As direct service industry ("DSI") customers of BPA, the companies continued to receive the vast majority of their power supply from BPA at cost-based rates. While some supply diversification took place in the early 1990s by a number of DSI's and public utilities, most of the aluminum companies continued to look to the federal hydro system as the cornerstone of its power supply.

The aluminum companies continue to be direct service customers of Bonneville, but Bonneville is severely limiting the amount of power it is offering to sell to the companies. Where Bonneville used to supply about 95 percent of Northwest aluminum load, it is now offering to supply only 40-50 percent of the industry's needs, and some of that power will be priced at market rates instead of traditional rates based on the cost of federal generation resources. This is a serious concern. Moreover, BPA's projections for the next rate period, 2006 and beyond, suggest that they will offer even less cost-based power to the companies. Alcoa believes that the BPA direction is not consistent with the intent nor the letter of the Northwest Power Act. Alcoa also believes BPA's direction conflicts with the Regional Preference Act that was enacted in 1964 to protect access for regional customer when additional transmission lines were being built from the Northwest to the Southwest.

Slice of the System

Alcoa is concerned about the "Slice of the System" product ("Slice") for a number of reasons, not the least of which is that it is a highly technical product, which could have substantial, unanticipated effects, and the public debate has primarily involved only customers with a vested interest in purchasing. As a result, there has been no unbiased appraisal of what impact this product will have on other BPA customers or, more importantly, whether it is even authorized under the Northwest Power Act. That is why we applaud the Subcommittee for holding this hearing and taking a step back to analyze Slice in a larger context.

Under Slice, BPA offers to sell a percentage of the output of federal resources, and some control over it when that percentage is available, in return for the pro rata cost of such resources. We do not claim to know every detail of the Slice product, but what we do understand causes concern. First, the concept of selling a set percentage of the variable output of BPA's power resources appears to be outside BPA's authority under the Northwest Power Act and, therefore, illegal. We can find nothing in the Act authorizing BPA to, in effect, sell or lease its resources, as opposed to selling fixed quantities of the power generated by those resources. The Slice contract may also violate the Urgent Supplemental Appropriations Act of 1986 which provides that no federal funds may be used to transfer out of federal ownership, management or control, in whole or in part, any facilities or functions of the federal PMAs. While the Act could be amended to allow Slice-type of power sales, no move is underway to do so.

Assuming the concern regarding the inherent legality of the product can be overcome, Slice is a dramatic departure from any previous product offered by BPA and should be approached cautiously. Alcoa is concerned that the Slice product as presently proposed understates the total revenue requirements associated with the power sale; a fault that will trigger cost shifting from Slice purchasers to other BPA customers. In theory, the Slice product sells a percentage of BPA's resource along with an equally corresponding percentage of the resource cost. However, some costs are excluded or underestimated, such as certain expenses associated with: (1) the residential exchange program sales to the IOUs, (2) the transmission system, and (3) administration of the Slice product.

In particular, Alcoa is concerned that Slice takes a snapshot of system costs as they exist at the time of contract signing and, while allowing an annual true up, does not allow for inclusion of different kinds of costs that later arise. For example, costs that result from new legislation or subsequent policy decisions regarding the system that do not meet the narrow scope of allowed costs outlined in Slice would also be excluded. In that case, costs associated with the operation of the federal hydropower system would be borne unfairly by non-Slice customers alone. In effect, Slice could inoculate its participants from costs generated by, among other things, Congressional or administrative decisions down the road.

This hearing is a good start toward the type of detailed analysis that Slice should undergo. The product and all its assumptions must be reviewed in the context of the Northwest Power Act, as it is reads now, and in the context of a future restructured energy industry. Until the product can be fully analyzed by all interested parties and Congress, Bonneville should continue its analysis, but not offer Slice in this contract period.

Slice is a highly innovative and intriguing concept, and it may be a very good concept for marketing federal power in the future, but it has not been sufficiently analyzed to rationally allow extensive use in this rate period. Alcoa recommends that before use as a long-term product, Congress should consider Slice in the context of a total review of the Northwest Power Act. Thereafter, if the Slice product is determined to be legal and appropriate, it should be offered to all BPA customers, not just public power.

BPA Contract Duration

As part of the Subscription Process, BPA has proposed power sales contracts to its public utility and investor owned customers for a term of over 10 years. Alcoa strongly opposes the letting of any contracts over five years in duration and we urge the Subcommittee to use its influence with Bonneville to discourage such action.

Congress has already started the national debate on energy restructuring with the intent of producing legislation as soon as possible. BPA's authorities and obligations in the restructured energy market will be defined by this legislation and will likely be significantly different than those defining its current role. It is not known today what BPA's role will be, but clearly it is for Congress and not BPA alone to decide what the future will hold. Locking the sale of BPA power into long-term contracts will usurp Congress's prerogative to change the laws applicable to BPA both in terms of national energy restructuring and the Northwest Power Act.

Congress's ability to pass and implement changes in federal policy affecting BPA will be severely limited if BPA is allowed to offer power contracts over five years in length. Regardless of changes made legislatively, where they conflict with the terms of the contracts, contract rights will prevail. It will result in a holding pattern in the Northwest market for the term of the contracts. Moreover, there is no need for such long-term contracts. Despite arguments that long-term contracts are necessary for financial security, Bonneville's own forecasts indicate that it will remain below even the lowest forecasted market price after 2002. Therefore, there should be no fear that the power will not be attractive in the market. Offering 10-year contracts will only serve to frustrate Congress' ability to make and implement appropriate legislative changes.

Important legislative changes are needed in the Northwest. Regional interests are working together with the four state Governors and Members of Congress regarding the changes that will define the future structure of the Federal Columbia River Power System. Possible changes include the formation of a Regional Transmission Organization ("RTO"), the separation of BPA's generation and transmission systems, and the possible formation of a Northwest-owned co-operative, or something similar. If 10-year contracts are signed tying up a significant portion of the federal power that is now available, the ability to move forward on any of these opportunities will be compromised.

Concurrently with national electric energy restructuring, Congress must address the Northwest Power Act, comprehensively, to ensure that important policy decisions receive a full and open hearing. A BPA witness testified before the House Commerce subcommittee last week that any substantive change in the Northwest Act must be approached comprehensively. Even the BPA Administrator has acknowledged in remarks to the press that the laws governing BPA are outdated. In a January 1999 Oregonian article Administrator

Johansen was reported to say "you've got a lot of industry restructuring and it's going to push us to the edges of our authority in ways that I can't even speculate right now. Until Congress says otherwise, I'm going to keep on doing what I'm doing." Having said that, BPA is now proposing to maintain those outdated laws without change for another ten-plus years through the signing of long-term power contracts. Conversely, BPA is offering only two-year transmission rates because it recognizes that it will soon need federal legislation to join an RTO. Where it wants to avail itself of federal legislation (in transmission), it limits its actions to the short term. Where it wants to avoid the impact of federal legislation (in power sales), it contracts for the long term.

A more rational course of action would be for BPA to offer contracts of no more than five-year duration. A term of five years would allow Congress to make effective changes in controlling laws and would provide a reasonable period of transition from a regulated to a competitive market. Short-term contracts would preserve Congress and the region's flexibility to assess what can and should be done with respect to policy decisions affecting BPA and the region's energy future in the context of national energy restructuring. Alcoa urges the Subcommittee to encourage Bonneville to only offer contracts of five years or less to its customers.

Regional Transmission Organization

FERC's Order 2000 established an October 2000 deadline for jurisdictional utilities to participate in an RTO filing (or explain the reasons for their failure to participate) and a December 2001 deadline for RTO operation. While not a jurisdictional utility, BPA is interested in participating in an RTO and will attempt to comply with this schedule.

BPA's participation in a Northwest RTO will require additional legislative authority from Congress. BPA requires legislation because FERC Order 2000 stipulates that an RTO must be independent. For example, the RTO must be responsible for proposing rates over all transmission facilities that are owned or controlled by the RTO. Under present law, only the BPA Administrator can establish rates for transmission services over federal facilities. Therefore, BPA cannot delegate this responsibility to the RTO without fundamental statutory changes.

The fact that Bonneville needs legislation to participate in an RTO is another argument for a comprehensive review of the Northwest Power Act. Together with the Slice product and other issues, Congress should include BPA's RTO participation in an effort to update the Regional Act. One of the RTO issues that should be considered is the possibility of cost-shifting to BPA's transmission customers due to the formation of a Northwest RTO.

BPA Contingency Fund

BPA is seeking to accumulate a large and unprecedented reserve fund of over \$1.25 billion during the 2002-2006 contract period; the highest reserve fund in BPA's history. Over the last 10 years, BPA has maintained an average reserve level of \$200-300 million without any negative consequences. While a \$200 million reserve may be low, the level being considered is unprecedented. Alcoa opposes the accumulation of such a fund and believes that those funds should be used to serve historical customers, such as the aluminum companies. Indeed, if BPA were to hold its cash reserves at the level it is forecasting for year-end 2000 (\$700-800 million), it could maintain the economic viability of the region's aluminum industry by providing substantially more cost-based power than it is presently offering.

BPA claims higher cash reserves are necessary to assure payment of operating expenses and federal debt. That conclusion is incorrect. Current rate levels provide ample revenue to pay for BPA's expected financial obligations. It is important to note that BPA has not missed any part of a Treasury payment since 1983, with much lower reserve levels than it has now. As a protection, in 1987 BPA instituted a cost recovery adjustment clause (CRAC) in power contracts to allow for an automatic rate increase whenever BPA reserves got so low that repayment was jeopardized. The 2002-2006 contracts will continue to use the CRAC as a risk mitigation device. Since 1987, BPA has never needed to implement the CRAC, but it does provide a contingent source of revenue as a safety net.

BPA also argues that the expanded reserve fund is simply the result of an established Treasury Payment Probability ("TPP"); but there too, BPA has increased expectations. This rate case includes an increased requirement for TPP despite forecasts of lower than market rates into the future. The following table compares payment probabilities over the last three rate cases.¹ Since the rate cases varied in length from one to five years, we have equalized them on a one and five year basis for ease of comparison.

<u>Rate case</u>	<u>Probability over 5 years</u>	<u>Probability over 1 year</u>
Pending -- 5 year rate period (FY 2002-2006)	Proposed - 88%	Proposed - 97.5%
1996 -- 5 year rate period (FY 1997-2001)	80%	96%
1995 - 1 year rate period (FY 1996)	44.4%	85%

Were BPA to maintain its current probability of 80 percent over the next five-year rate period, it would still increase expected end-of-rate-period cash reserves with cushion far above anything collected in the past.

The accumulation of the projected \$1.2 billion-plus reserve fund is wholly inconsistent with the statutory requirement that BPA establish the lowest possible rates that are consistent with sound business principles. Were BPA a private utility, such hoarding of ratepayer money would not be tolerated. No utility would be allowed to set rates above costs to accumulate the level of cash reserves that BPA proposes. The fact that it is a government agency collecting the fund scarcely makes the policy any more defensible.

The question of when BPA may need or use the funds is relevant. BPA is prohibited from collecting funds for purposes not forecasted by the Administrator to be expended during the rate period. This prohibition was included in the 1999 Energy and Water Development Appropriation Act (for FY 2000) by Senator Slade Gorton to prevent the accumulation of large cash reserves to pre-fund dam breaching, drawdown or other controversial activities. A lower reserve fund would eliminate a very tempting revenue source that could be used for purposes not authorized by Congress.

Alcoa is very concerned that BPA's aggressive cash accumulation is detracting from its ability to serve its historical customers. If, rather than doubling its reserve fund, BPA maintained a reserve level of \$700 million, then it would free up substantial funds to comply with the Regional Preference Act and supply Alcoa and the other aluminum companies with cost based power. In addition, a reduced reserve fund would

provide BPA greater motivation to control costs and operate in a more efficient and market-oriented manner.

Conclusion

Alcoa strongly believes that the time has come for a comprehensive review of the Northwest Power Act. The Act is now 20 years old and was never designed for application in a deregulated electric industry. Indeed, the Slice product is a good example of BPA customers trying to bootstrap the authorities of an out-of-date law into a product useful in a more open and competitive market. The Slice may be a good way for BPA to sell power to Northwest consumers in the future, but at the present time, they are not authorized to sell power this way, and should not proceed until authorizing legislation is passed. It is just another example of how dated the Northwest Power Act has become.

Alcoa urges the Subcommittee and the Northwest Delegation to undertake a complete review of the statutes and authorities governing the Bonneville Power Administration and include the entire Northwest Power Act in its consideration of national energy restructuring. Meanwhile, Alcoa requests that the Subcommittee to use its influence with Bonneville to limit the term of power contracts to five years and to limit the level of cash reserves to a level of \$700-800 million.

Thank you for this opportunity to testify.

1. Prior to the 1993 rate case, Bonneville did not use Treasury repayment probability as a measure of the adequacy of its rates.

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